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INVESTMENT NEWS

Investment Update September 2020

We have decided to stop the Covid-19 series of bulletins, as over recent months, the market has settled down to a more normal state. The volatility has been a gift to hedge fund managers but otherwise we seem to have settled at current levels. Vanguard have produced Sterling rebalanced equity market figures which show that from the pre-CV-19 peak the US market has recovered, whilst Europe is perhaps 20% down, and the UK is nearer 30% below its highest point.

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INFLATION

The Office for National Statistics (ONS) has just released the UK inflation data for August. This showed consumer prices rising at an annual pace of 0.2%, down from a previous 1% annual rise in July. UK inflation has not been at this low rate since the end of 2015.

As long-only investors, the future course of inflation is very important to us. If inflation remains subdued then asset backed investments may perform less well than cash, property, and fixed interest investments. On the other hand, if inflation returns, then you want to be in equities.

Money supply has increased significantly in recent years; however, the cost of money has dropped to virtually zero. This excess of cash is likely to cause asset bubbles. There is currently no demand for increased wages in the labour market, and the CV19 effect on the economy suggests that demand will remain subdued for some time to come.

Looking longer term, governments need inflation to erode their massive government debts, and will no doubt favour inflation as a means to start balancing the books.

BONDS

The asset price bubble continues to make fixed interest investments obscenely over-priced. The UK 50 year gilt yield is standing at 0.47%; why would anyone lend the UK government money for 50 years at that rate of return? Nonetheless, the Government have sold £220 bn of Gilts in the period April to July 2020. (They sold only £127 bn in the whole of 2019).

We continue to hold little or no bonds in our portfolios. If Berkshire Hathaway can hold $122 Billion in cash, we don't feel embarrassed to use the asset in a similar way.

COMMERCIAL PROPERTY

There is no doubt that one of the hardest hit sectors of the economy has been commercial property.

Restaurants, pubs, and clubs have had zero income for many months. Shops have seen a huge reduction in foot fall.

Offices have been empty whilst the staff discover the delights of home working.

Property funds have been suspended to prevent being over-run with redemptions. Legal and General have just announced they will be unsuspending their property fund on the 13th October. Hopefully, other funds will follow suit soon afterwards.

Whilst we do expect falls in capital values when the suspended funds finally return to the market, we are not as negative regarding the longer-term outlook as many pundits suggest.

- In offices for instance we are seeing the Covid restrictions mean that whilst only ½ the staff are going in to work; they need twice the space to work safely. The office is becoming a place where your team meets, not necessarily where everyone works full time.

- Shopping is a pastime, not always a necessity. Retailers will adapt to this new lifestyle.

- We all like to be entertained, and the hospitality industry is being innovative in their new approach to things, such as in adopting the use of an App for ordering. I personally think apps are a great idea and much better than the previous queue at the bar system.

So, we will not be rushing for the door when funds come on stream again, but we will be cautious over new fund purchases. Right now, we really like long lease steady yield alternatives.

A further complication with property fund purchasing, is the FCA's suggestion that the normal notice period for any Property fund redemption should be 180 days (i.e. 6 months). We cannot see anything wrong with the current system, however if this ruling does come in then we shall have to be careful that it doesn't create client liquidity issues in the future.

EQUITIES

We generally think that equity prices assume the best of all recoveries. Israel was the first country to announce a second country wide lock down last week. ICU capacity in Spain and France is also becoming stretched. A second major lockdown is a definite possibility, which we believe has not been accounted for.

Covid-19 remains probably the biggest influence on global economic activity, and hence will affect asset prices more than anything else. You can narrow this down further to the development of a vaccine being the single most influential factor in the current marketplace.

Vanguard have a 35% possibility of National shutdowns returning, the Virus mutating (as did Spanish flu in the autumn of 1918) or a vaccine taking longer than expected.

UK Equities

The figures show there was a 25% fall in GDP in the first 6 months of 2020. However, there was a 10% recovery in August. Vanguard estimate the recovery to pre CV19 levels will take until December 2022. Unemployment will rise, and the economy won't recover for a very long time.

The larger stock continue to perform well. Sterling lost 3.5% of its value recently and that always reflects well on FTSE 100 companies, many of which earn their returns in dollars.

Most fund managers are sanguine over whether we get an immediate BREXIT deal or not (L&G estimate an 80% chance of a hard BREXIT). It seems Boris wants WTO terms not the deal previously struck, and there is a Russian roulette battle going between the EU and the UK to see who breaks off negotiations first and so can be blamed for the result.

Perversely, if and when BREXIT is resolved (whatever that might be) and more certainty returns, then expect the FTSE 100 to suffer as the pound strengthens. We remain diversified throughout the UK market.

House prices rose 1.6% in August from July's level according to the Halifax House Price Index. The annual increase in house price accelerated to 5.2% from July's 3.8%, hitting its highest level since 2016.

US Equities

These have had a fantastic run. The Nasdaq has risen 75% from its low point and is showing Bubble life tendencies. The US is very dependent upon Tech stocks, and the up and coming election could cause significant volatility (see US China Trade War below).

Whilst in the short term a Democratic win may be worse for equity prices, longer term history suggests it makes little difference who has the presidency. Of more concern is a contested result. There are big questions over the authenticity of postal votes and there are significant numbers of voters not yet registered to vote.

European Equities

The eurozone is now in a pickle. Despite decent economic recovery being apparent, prices are not only decelerating, but falling: the latest eurozone inflation data saw prices fall 0.2% in August (France has domestic inflation of 0.2%, but German prices are static while Italy, Spain and Greece saw prices fall by 0.5%, 0.6% and 2.1% respectively). Governments and policymakers fear deflation. For the big exporting countries, particularly Germany and Italy, a rising exchange rate makes their exports more expensive, creating further potential difficulties.

Unlike homogenous economic systems such as the UK, US and Japan, the eurozone still labours under a regime which has 19 countries sharing a common interest and exchange rate, regardless of their individual economic, political, and social circumstances, while not having a symmetrical, complementary fiscal union to create a fully integrated economic system. We still think the Euro is a doomed concept, but it may well stagger on for many years to come.

The US China Trade War

There is a great article from L&G which explains the “Thucydides trap”. This concept speculates that when a ruling power (in this case the US) feels sufficiently threatened by a rising power (China), the ruling power may engage in pre-emptive measures with the challenger in order to protect its position. The threat of a China-US standoff today might consist of trade tariffs and cyber-warfare.

If Donald Trump finds that COVID-19 is still high and economic recovery has stalled, then what are the chances he will pick another fight with China to boost his ratings?

GOLD AND SILVER

Gold and silver have been two of the best performing assets in 2020. Our current asset allocation is for 10% of clients' funds to be in precious metals, and this has proved highly successful.

Looking forward we hold precious metals as a hedge against big equity falls, so it follows that if equities do bounce back, precious metals will underperform.

ASSET ALLOCATIONS

Our Asset Allocation choices are somewhat varied at present due to the suspension of property funds. However, if we include property, our current geographical choices are:

Cash	6.00%
Property	17.00%
UK Equities	27.00%
International Equities	30.00%
Emerging Markets	10.00%
Precious Metals	10.00%
	100.00%

A lot of funds are carrying high levels of cash which is why the cash element is higher than normal.

FACTOR INVESTING

In the last 18 months we have been increasingly introducing diversifiers into our portfolios.

We are allocating 20% of assets to Factor Funds right now, with the split approximately:

Minimum Volatility	4.00%
Value	4.00%
Small Cap	4.00%
Biotech	2.00%
Automation & Robotics	3.00%
Infrastructure Spend	3.00%
	20.00%

Value stocks, which trade at low prices relative to their fundamentals, have underperformed for many years. Currently we favour Value shares over Growth shares, Infrastructure stock over more cyclical stock, and Minimum Volatility choices where we can keep risks down.

Factor investing entails ***active fund choices,*** which blurs our passive approach however we feel that the introduction of low cost Factor alternatives such as Vanguard's Global Value fund, which has an OCF of 0.22%, makes the proposition worthwhile.

SUMMARY

However negative we may be on the fundamentals; it remains that savings rates are up, and the wall of money being invested is justifying current and possibly higher future values. We believe the best approach is to diversify clients' holdings so as to optimise returns in the years ahead.

The information and statistics provided in this bulletin have been taken from several sources and are available upon request. The figures are approximations and conjecture and should not be relied upon. You should not act on any comments made herein without a personal consultation and discussion with your financial adviser. Figures given today will change tomorrow. ADLS 17/09/2020.

Investments are subject to market risk, including the possible loss of the money you invest. Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. Diversification does not ensure a profit or protect against a loss in a declining market. Performance data shown represent past performance, which is not a guarantee of future results. Note that hypothetical illustrations are not exact representations of any particular investment, as you cannot invest directly in an index or fund-group average.

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